

BUSINESS, TRANSPORTATION AND HOUSING AGENCY

California Film and Television Tax Credit Program

Title 10, Chapter 7.75, Sections 5500 - 5507

INITIAL STATEMENT OF REASONS

SPECIFIC PURPOSE OF THE REGULATION

The proposed regulation will amend some of the procedures for allocating California Film and Television Tax Credit Program tax credits to qualified taxpayers in the motion picture industry.

NECESSITY

Revenue and Taxation Code sections 17053.85 and 23685 provide for a California tax credit for qualified expenditures in the production of a qualified motion picture in California for taxable years beginning on or after January 1, 2011.

Revenue and Taxation Code sections 17053.85 and 23685 provide that the California Film Commission establish a procedure for applicants to file a written application for the allocation of the tax credit, establish criteria for allocating tax credits, determine and designate applicants who meet the requirements to apply for the tax credit, and issue the credit certificate to the qualified taxpayer upon completion of the qualified motion picture.

The California Film Commission promulgated regulations in 2009/10 and implemented the California Film and Television Tax Credit program in June 2010. The program which specifically targets productions that are most likely to leave the state to take advantage of incentives being offered in other states and countries is very successful. However, in administering the program for the past five months, both staff and applicants have identified areas that should be amended to either facilitate or clarify the process of acquiring the tax credit.

The California Film Commission proposes to amend sections 5500, 5501, 5505, 5506 and 5507. This proposal will also amend the California Film Commission forms, incorporated by reference, that are required to be submitted during the application and filming process.

Section 5500 is amended to add a definition of Hiatus. This term is used in these regulations and the practice is common in the filming industry. It is important that the production company understand the use of the term, because if they take a hiatus over 100 days, they can disqualify themselves from the program.

Section 5501 provides for the application process for a tax credit allocation. Section 5501(c) amends the revision date for the Application Form, CFC Form A (Rev 10.20.2010), hereby incorporated by reference. This revision is for clarity.

Section 5501(d)(5) repeals CFC Form B, Financing Sources Report. The information required on this form has been moved to the Application Form, CFC Form A. This will reduce the amount of forms the applicant is required to submit.

This revision is for clarity. The form will not be required.

Section 5501(h) is amended to add a requirement that if a production company implements a hiatus during the principal photography period, it may be no longer than 100 days. This revision is to limit the amount of time credits can be reserved for an approved applicant who has not yet completed principal photography.

Section 5505(a)(4) amends the reference to Fiscal Year-End Expenditure Report, Form K (Rev. 10/20/2010), hereby incorporated by reference. This revision is for clarity.

Section 5506(a)(1) will be repealed. The information required on the Tax Credit Certificate, CFC Form J, has been moved to the Expenditure Summary Report, CFC Form F. This will reduce the amount of forms the applicant is required to submit.

Section 5506(a)(5) amends the revision date to Expenditure Summary Report, CFC Form F, (Rev. 10/20/2010), hereby incorporated by reference. This section is also renumbered to (a)(4) to be consistent with the numbering. The revisions are for clarity.

Section 5506(a)(6) repeals the Employment Diversity Report, CFC Form H, which was incorporated by reference. This is for clarity. This information has been moved to the Expenditure Summary Report to reduce the number of forms required in this program.

Section 5506(a)(7) is amended to require that the CPA preparing the Agreed Upon Procedures Report to either have as active California CPA license or a practice privilege permit to perform attest services in California. This amendment will allow a certified public accountant certified in another state to produce this report. This was added pursuant to the California State Board of Accountancy. This section is also amended to require the CPA to successfully complete the CFC orientation meeting for CPAs before they can work on the AUP. The training will provide the CPA detailed information on the procedures and requirements of the program that are unique to the film industry. This will insure the AUP is complete and correct. This section also amends the Agreed Upon Procedures to the new version dated 10/20/2010, hereby incorporated by reference. The revision also requires the report prepared by the CPA to be in a specific format as provided in Appendix B. The required format will provide for consistency in information provided to the Commission and will facilitate review and approval of the request of the Tax Credit Certificate. This section is also renumbered to (a)(5) to be consistent with the numbering. This revision is for clarity.

Section 5506(a)(9) is editorially amended to renumber as (a)(7) for clarity. This section also adds a requirement that documentation verifying the total dollar amount of work performed within California be submitted for any post sound company contract work. This section previously only required documentation from each visual effects, title and or digital effects work contracted by the production company. As digital and post sound work can be performed out of the state, it is necessary to verify that the work was performed in California and therefore would qualify for tax credits.

A new section 5506(c) will define when a Qualified Motion Picture is complete. This language is moved from 5506(a) for clarity.

Section 5506(c) is amended to clarify that the Director shall determine if the material submitted by the applicant are sufficient to meet the requirements of these regulations. The Director also may reject insufficient documentation not in compliance. This amendment will specifically provide for disapproval of the tax credit certificate because of insufficient documentation. This is for clarity. This section is also renumbered to (d).

Section 5506(d) will provide that upon rejection of insufficient documentation, the applicant will receive a notice of disapproval. This is for clarity to insure the applicant knows that the request for tax credits can be rejected for either not meeting the program criteria and/or insufficient documentation. This section is renumbered to (e).

Section 5507(a)(1) amends the on-screen acknowledgement requirements to include the “State of California”. It previously only required the California Film Commission, and acknowledgement to the state was deemed appropriate, as this is a state-wide program.

A new subsection (a)(4) is added to require the production company to add the California Film Commission official logo in the end credits. The inclusion of the CFC logo helps to advertise that the film was produced in California and further the goal of marketing the state as a place in which to film.

California Film and Television Tax Credit Program Application Form, CFC Form A, Rev 10.20.2010

The Application Form has been amended. The statute specifies that the California Film Commission shall establish a procedure for applicants to file with the Commission a written application. The application form has been jointly prescribed by the California Film Commission and the Franchise Tax Board, as required by statute.

The amendments to this form are both editorial and substantive. The form was reformatted for clarity and ease of use for the applicant. It also further defines some of the categories to avoid confusion. In Section One, now titled “Applicant Information”, it clarifies that the date will be the date they are completing the form, it will specify that you need to include the title of an individual if applicable and clarifies that the company means the production company. As written, it was confusing as to whether to insert the name of the applicant company or the production company. This section no longer will require the applicant to insert the date of formation of the production company. This was not relevant to approval of the request for tax credits.

Section Two requires the name and address of the production company representatives. This section is amended for clarity. It clarifies that a Studio Representative may also be submitted as the contact for the Production Company. It also provides a box to check if all the information is the same in Section 1, and allows the applicant to skip to the next section. This will reduce the time involved in completing the form for the applicant.

A new section M will require the name and license number of the CPA that will perform the Agreed Upon Procedures. This will be used to verify that the CPA has completed the orientation meeting as required in these regulations and to avoid problems with the applicant hiring an unqualified accountant. However, this section also provides a box to indicate that the CPA has not yet been chosen. The program understands that the Applicant may not yet have this information and will follow-up with the applicant upon approval of the credit allocation letter.

A new subsection is added to the Eligibility Determination Section. It is B. Independent Film Declaration. This information was originally a separate form, Independent Film Declaration, CFC Form C, and is being moved here to reduce the amount of paperwork required to be completed. This form is only required from a production applying for tax credits allocated to an independent film. This section requires the applicant to list the name of the production and the production company for identification purposes. This section will be used to verify that the film is independent by identifying the ownership. This form requires a certification by the applicant under penalty of perjury that the information is true and correct.

In D. Principal Photography Days the applicant will now be required to estimate the total CA 2ndUnit/stunt/VFX days. These shoot days are separate from principal photography days in that they do not apply with respect to the 75% principal photography days needed as one eligibility criteria for the program. However, the qualified wages and expenditures created from these filming days do apply toward the applicant's tax credit allocation.

A new Section 4, Financing Sources is added to this form. This information was originally a separate form, Financing Sources Report, CFC Form B, and is being moved here to reduce the amount of paperwork required to be completed. This section will identify the financing sources for the production. The applicant is required to list the name of the financing source, the amount and the percentage of financing for the project it represents. This is required to insure that the project has a substantial amount of financing secured. The CFC's intent is to increase employment and spending in California by allocating tax credit to productions filmed in California. If the funding is insufficient, the film will not be produced, the State sees no benefit and other productions denied tax credits reserved for such productions may decide to film in another state.

A new section 5, Production Statistics is added to this form. It will require the applicant to give estimates of the number of persons working on the production, including cast members, base crew members and extras and stand-ins. The CFC is bound by the statute to report statistical information on the employment created as the result of motion pictures receiving the credit and choosing to film in California.

Section 6. Is amended editorially to add areas for CFC staff to make notes on the application form.

Expenditure Summary Report, CFC Form F

This form is used to gather final expenditure information and statistics upon completion of a Qualified Motion Picture. The form requires the Applicant information, including the production title, company and Credit Allocation Letter number for identification purposes. This part of the form has been amended to be consistent with the Application Form, CFC Form A. It now clarifies that the date will be the date they are completing the form, it will specify that you need to include the title of an individual if applicable and clarifies that the company means the production company. As written, it was confusing as to whether to insert the name of the applicant company or the production company. It also requires the Applicant to resubmit the name and address information because after principal photography is completed and the project is in post-production, the company will often close the main production company office and move to another location. This will insure that the CFC has the current information on file.

The form has been amended to require the Payroll Service Company, Distributor and the CPA information. The program may need to contact the payroll service or CPA with any questions that arise when reviewing their request for the tax credit certificate. Distribution information enables the program to track when the production may be released and verify it has complied with the credit provisions in the regulations.

The Eligibility Determination section is amended to require additional statistics on the Principal Photography Days, including days filming in Los Angeles area, days outside 30-mile studio zone total, days of Ca 2nd Unit, stunt, VFX and Total percentage of days filming in California. The section will also require the company to list all the locations used to film by county in California and/or by state or country. This is required to confirm that 75% of the principal photography days were in California as required by statute. The information on the specific locations filming occurred in California will be used to determine the economic impact on the different counties in the state.

The Production Statistics section is amended to require the applicant to include the number of persons

working on the production, including cast members, base crew members, extras and stand-ins and vendors. The information on this form will be used to determine the economic impact on the state, including employees hired and wages in both production and post-production. The CFC is required by statute to submit economic impact reports to the legislature.

Two new sections, California Taxable Spend/Taxes Withheld and Total Production Budget, are added. Applicant will be required to include the breakdown on the qualified and non-qualified expenditures on good and services subject to California Sales or use taxes and total state income taxes withheld. They will also be required to provide the total California expenditures. The CFC is required by statute to submit economic impact reports to the legislature.

A new Section D. Employment Diversity Information is added to this form. This information was originally a separate form, Employment Diversity Report, CFC Form H, and is being moved here to reduce the amount of paperwork required to be completed. The CFC is required by statute to report on the diversity of the workforce in the Qualified Motion Pictures produced as a result of this program. The production company will submit the ethnicity for each hire on the Qualified Motion Picture, based on the information provided by the employee, and indicate the number of days worked. Information is only used for statistical information.

The form is also amended to require the applicant to enter the Credit Allocation Letter Amount originally determined by the CFC and the Final Credit Allocation number. They are required here for consistency in using this form as a tool to summarize the findings and to do a review of the final credit allocation numbers submitted.

Fiscal Year End Expenditure Report, CFC Form K

The form has been reformatted with new header print and type. A CFC Use Only box has been added. These changes will not affect the regulated public. This form is intended to be used by a company that has not completed filming by the end of the fiscal year in order for the CFC to have information about fiscal year end about that production. If the company completes production before July 30th of any given year, they are only required to complete the Expenditure Summary Report.

Section 1. Application Information, is amended to specify that the program requires “Today’s” date, instead of date. The section requiring the “Applicant” is amended to require “Applicant” entity or “Individual/Title” if applicable. The Company Name is amended to request the “Production” Company Name. These changes are consistent with the other forms used by the program. This will insure that all information submitted to CFC is consistent and will be attached to the correct files.

Section 2. Labor Statistics for in-State Work, is amended to require additional statistics on the Principal Photography Days, including days filming in Los Angeles area, days outside 30-mile studio zone total, days of Ca 2nd Unit, stunt, VFX and Total percentage of days filming in California. The section will also require the company to list all the locations used in the film by county in California and/or by state or country. The information on this form will be used to determine the economic impact on the state. The CFC is required by statute to submit economic impact reports to the legislature.

Section 3. California Taxable Spend, is amended to add to the title “Taxes Withheld”. The production company will be asked to include the breakdown on the qualified and non-qualified expenditures on goods and services subject to California Sales or use taxes and total state income taxes withheld. They will also be required to provide the total California expenditures. The CFC is required by statute to submit economic impact reports to the legislature.

The signature box is amended to require the person signing the form, to sign under penalty of perjury. This is to insure that all information submitted is correct.

Agreed Upon Procedures (AUP), dated October 20, 2010

The AUP is a technical tool for the CPA to determine what is required and expected in the Agreed Upon Procedures Report required to be submitted by the Qualified Taxpayer in order to be issued a Tax Credit Certificate. The AUP has been amended to be consistent with all the changes to form requirements in these regulations.

The AUP General Section was amended to state that the CPA must submit with the report a copy of their CPA license or privilege permit number and contact information for the person or firm supplying services. This takes into account that the CPA license may be either for an individual CPA or the firm performing the Agreed Upon Procedures.

Section IV. Agreed Upon Procedures

Eligibility. This section is amended to require the preparer to identify litigation or insurance claims and the impact on the total production expenditures. Due to budget thresholds, litigation or insurance claims could disqualify or reclassify a project, and this clause will allow CPAs to identify any such overages and remove them from either the qualified budget total (independent films) or the total production budget.

Expenditures. Section g. is amended to provide for procedures for qualified items which required full or partial payment made prior to the issuance of the Credit Allocation Letter. The program is aware that certain costs may be paid in full prior to the issuance of the Credit Allocation Letter, and allows those costs to be qualified on a pro-rata basis.

A new section (i) requires that the preparer confirm the expenditure is pro-rated to reflect any usage out of the state. Only expenditures and labor performed in the state qualify, so the preparer must confirm the qualified amount of labor and materials used only in the state.

A new section (j) requires that the preparer confirm that insurance deductible were not included. Insurance deductibles are not qualified expenditures and therefore must not be included in the qualified expenditure total.

Section 3. is amended to clarify that the preparer is to obtain a fixed asset listing and list the type of assets included. This section also provides for detail on assets over \$10,000 and the procedures to follow. The program allows tax credits on either 20% or 50% on specific types of assets which the preparer needs to identify and confirm.

Section 7 is amended to require the preparer to adjust the Qualified California Production Expenditures for known errors. The program does not provide tax credits for non-qualified expenditures and is requiring the preparer to exclude known non-qualified expenditures when found during the sampling process.

Payroll.

Section 1 is amended to provide more specific instructions to the preparer on obtaining detailed payroll reports, including requiring them to compare and reconcile the payroll reports. By reconciling payroll reports with the "Bible" on a sum total basis, the preparer will be able to determine any unexplained variances and disallow variances over \$25,000, as they can not be confirmed as qualified wages.

Section 2 is amended to specify that the CPA must select a sampling of qualified wages in the Bible and reconcile the amount for the individual with the payroll report. Section a. requires the CPA to be sure that the wages that the company claims were paid agree with the wages as shown in the payroll company report.

New sections (f), (g), and (h) specify regulatory parameters which the CPA must confirm during sample testing. These parameters include disallowing wages for out of state work, work incurred prior to the date of the credit allocation letter, and wages that were incurred more than 30 days after the creation of the final elements.

Section 3 is amended to specify those individuals who receive both an above the line and a below the line credit and the amount of the below the line salary that is considered qualified. This section provides information as to what the CPA can consider qualified below the line wages in specified categories and requires the preparer to include a listing of the qualified compensation for individuals receiving qualified wages who also have a producer credit.

Sections 4 and 5 are amended to specify that the production expenditures must be adjusted for known errors. The program does not provide tax credits for non-qualified expenditures and is requiring the preparer to exclude known non-qualified expenditures when found during the sampling process.

New section 5(c) is added and specifies that a listing of exceptions be included. The program needs to review the exceptions listed to verify the final tax credit allocation.

Related Parties and Other Affiliations.

This section was amended to clarify the details on obtaining a schedule listing of all related party transactions from the production company. It will also require the preparer to select samples of related party transactions for testing. The preparer will also need to note any transaction not at an arms length standard and provide a listing of all related party transactions. The program needs to ensure that rates and fees charged by related parties are reasonable and comparable to those that would be charged by an unrelated party.

Exhibit A is amended to include a Final Credit Amount, which is the Tax Credit Allocation based on all the findings. A non-substantive change was made for reference under the Eligible Tax Credit, to show the percentages allowed by statute. This change is for clarity, as the tax credit amount due and the credit allocation amount may be different from the final credit amount.

Appendix A is a sampling chart to be used in the Agreed Upon Procedures and has not been amended.

An Appendix B, Sample Format for the Agreed Upon Procedures Report is proposed to be added to the AUP. This format is identical to the requirements in the Agreed Upon Procedures, except for requiring the information on the production and the CPA in the beginning of the report. It will also require the CPA to provide a statement establishing the intent and procedures followed to complete this report. In order to ensure conformity in the Agreed Upon Procedure reports, as well as assist CPAs in providing their findings, the program included Appendix B for this purpose.

TECHNICAL, THEORETICAL, AND /OR EMPIRICAL STUDIES, REPORTS, OR DOCUMENTS

The Commission did not rely upon any technical, theoretical, or empirical studies, reports, or documents in proposing the adoption of this regulation.

REASONABLE ALTERNATIVES TO THE REGULATION AND THE OFFICE'S REASON FOR REJECTING THOSE ALTERNATIVES

No other alternatives were presented to or considered by the Commission. This regulation implements Revenue and Taxation Code sections 17053.85 and 23685.

REASONABLE ALTERNATIVES TO THE PROPOSED REGULATORY ACTION THAT WOULD LESSEN ANY ADVERSE IMPACT ON SMALL BUSINESS

The Commission has not identified any alternatives that would lessen any adverse impact on small business. This proposal will provide more opportunities for small businesses as more production companies decide to film in California.

EVIDENCE SUPPORTING FINDING OF NO SIGNIFICANT ADVERSE ECONOMIC IMPACT ON ANY BUSINESS

The Commission has determined that the proposed regulations would not have a significant adverse economic impact on businesses. These regulations will provide for an increase in revenues and employment in California by bringing more filming business into California.

SPECIFIC TECHNOLOGY OR EQUIPMENT

This proposal will not mandate the use of specific technologies or equipment.